

1. Meeting of the ERS Board of Trustees' Audit Committee



March 7, 2018



Public Agenda Item #1.1

*Call Meeting of the ERS Board of Trustees'
Audit Committee to Order*



March 7, 2018

Public Agenda Item #2.1

*Approval of the Minutes to the
December 13, 2017 ERS Audit Committee meeting - (Action)*



March 7, 2018

Questions?

Action Item



Public Agenda Item #3.1

Review of External Audit Reports - (Action)



March 7, 2018

Tony Chavez, Director of Internal Audit

Hillary Eckford, Audit Manager, State Auditor's Office

State Auditor's Office Financial Opinion Audit



Tony Chavez, Director of Internal Audit
Hillary Eckford, State Auditor's Office, Audit Manager

Fiscal Year 2017 CAFR

Financial Opinion Audit



- Two deliverables
 - Independent Auditor's Report
 - Report on Internal Controls

Reports are provided to the Legislative Audit Committee to summarize results.

Fiscal Year 2017 CAFR

Report on Internal Controls



- Material accounting errors in financial statements for the System's active and retiree insurance plans
- System did not properly implement part of a new accounting standard

ERS Finance corrected and disclosed all material errors before it finalized the financial statements

Audit of the Employees Retirement System's Fiscal Year 2017 Financial Statements

State Auditor's Office Audit Team:

Hillary Eckford, CIA, CFE (Audit Manager)

Kelley Ngaide, CIA, CFE (Project Manager)

Fabienne Robin (Assistant Project Manager)

Hillary Eckford, CIA, CFE

State Auditor's Office



Purpose and Scope of the Audit

Issue an opinion on the Employees Retirement System's (System) fiscal year 2017 financial statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.





Administrative and Other Matters

- Audit was conducted from August 1, 2017, through December 20, 2017.
- Auditors coordinated their work through internal audit but still had direct access to records, employees, and external service providers.
- The State Auditor's Office conducts all projects in an environment free of any threats that impair independence.



New GASB Standards

- GASB statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, is effective for fiscal year 2017. This statement addresses financial reports of defined benefit OPEB plans administered through a trust and requires additional note disclosures and required supplementary information related to OPEB liabilities.
- GASB statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, is effective for fiscal year 2018. This statement requires reporting the OPEB liability on the face of the employers' financial statements and additional note disclosures.
- Auditors will be issuing an opinion later this fiscal year on the System's fiscal year 2017 pension and other postemployment benefit liability allocation schedules.

Audit Reports



The State Auditor's Office issued three reports in December 2017:

- Independent Auditor's Report (opinion on the financial statements).
- Report on Internal Controls and on Compliance and Other Matters (required for audits performed in accordance with generally accepted government auditing standards).
- Report to the Legislative Audit Committee.



Audit Opinion

- Issued an unqualified opinion on the System's fiscal year 2017 basic financial statements, which include the accompanying notes.
- Applied certain limited procedures to the Other Supplementary Information and concluded that such information was fairly stated in all material respects in relation to the basic financial statements taken as a whole.
- Did not opine on the Management's Discussion and Analysis and the Required Supplementary Information; however, we performed limited procedures related to this information.



Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Auditors identified a material weakness in the System's controls:

- The fiscal year 2017 financial statements had material accounting errors in the proprietary fund related to:
 - Inappropriately reporting the net position of the retiree insurance plan as an asset in the active insurance plan.
 - Lacking support for a loan between insurance plans
 - Inappropriately applying a change in accounting estimate retroactively.
- In addition, the System did not properly implement part of a new standard, GASB statement No. 74, related to its special funding situation in the fiduciary fund.

The System corrected and disclosed all material errors previously omitted or recorded in error that auditors brought to its attention before it finalized the financial statements.



Questions

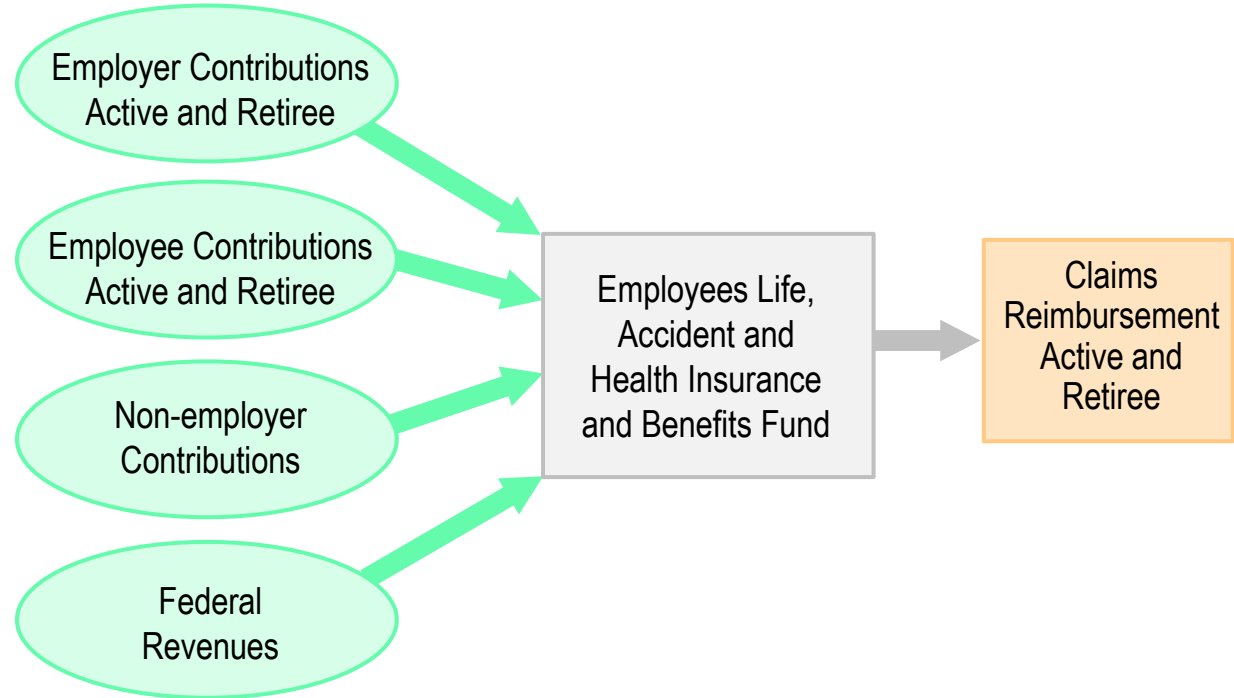
GASB 74 / 75 Updates



Machelle Pharr, Chief Financial Officer

Accounting before GASB 43

- One plan
- One appropriated fund
- Internal Service Fund for GASB reporting

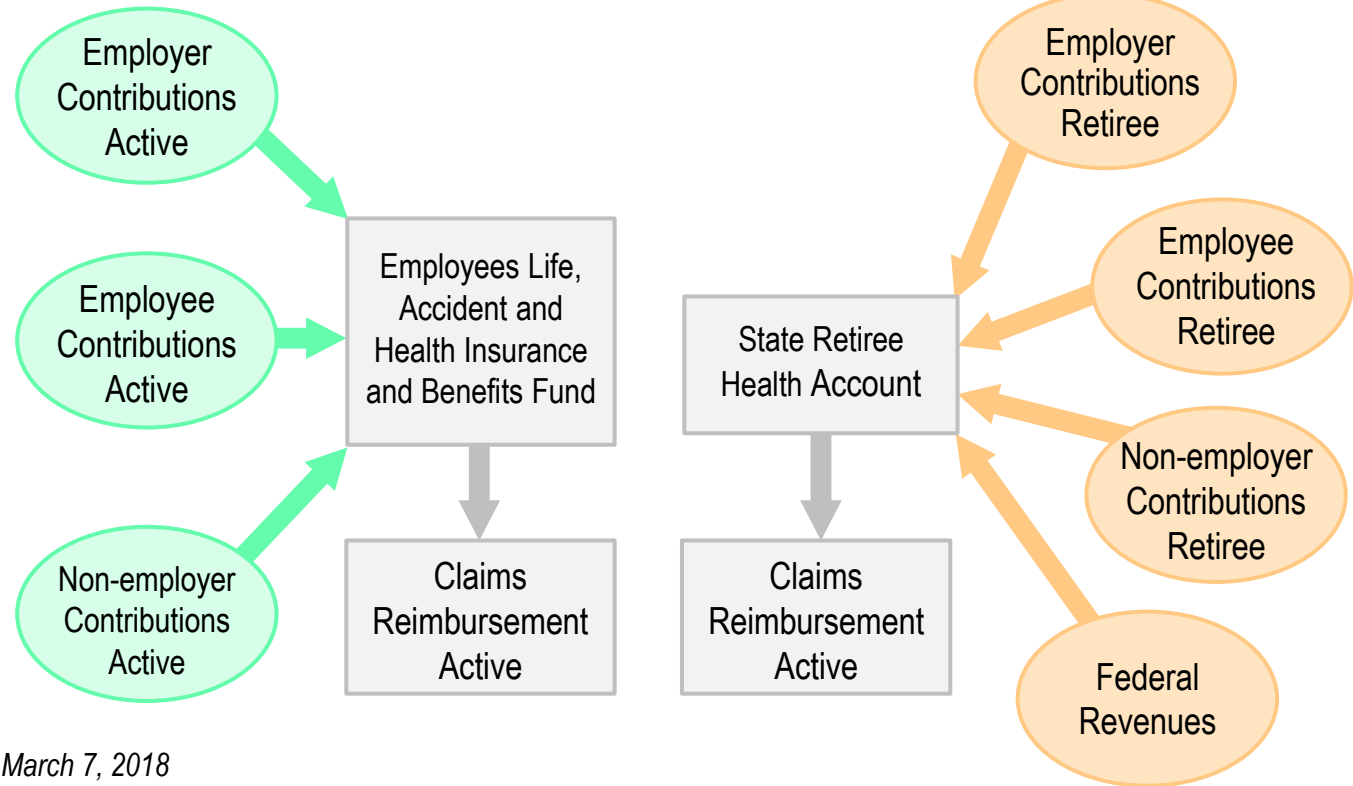


Group Benefits Program (GBP)

- One risk pool
 - Funding determined for GBP as a whole
- One rate for both active and retiree members
- Pay as you go
 - Entire fund balance for GBP reflected in the Internal Service Fund before and after GASB 43 effective date

Post-GASB 43 CAFR Reporting

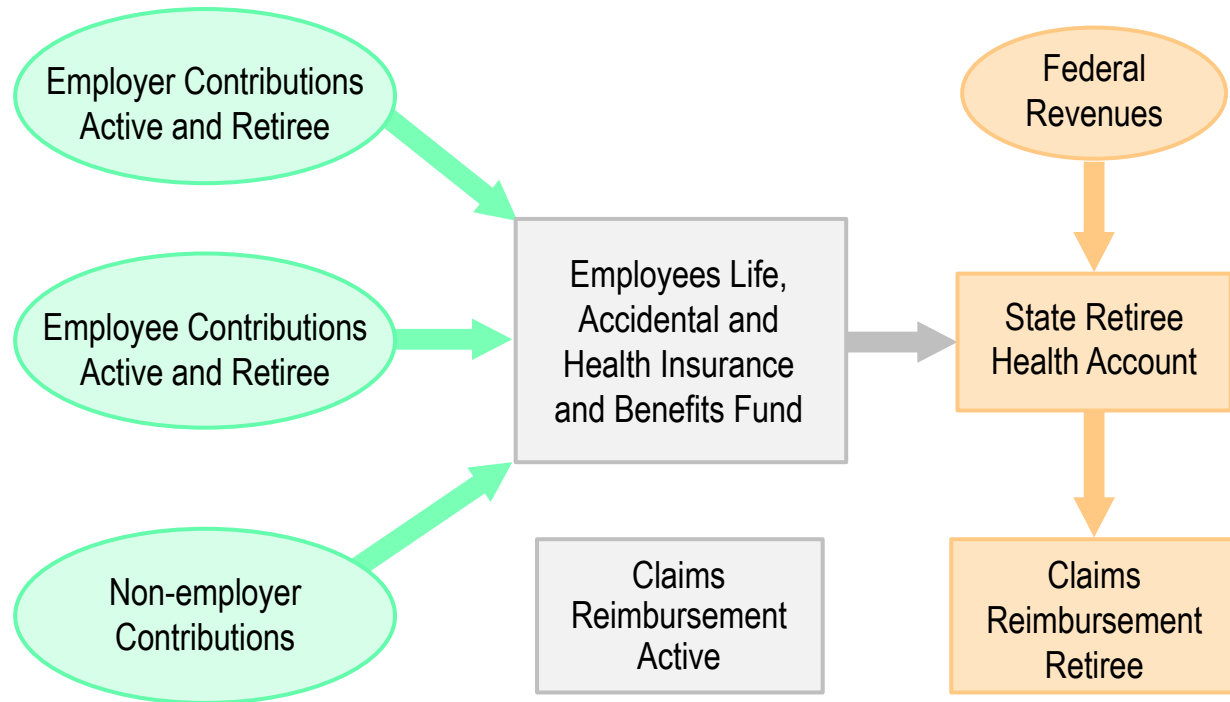
- One plan
- One appropriated fund
- Revenue deposit options
- Employees Life, Accident and Health Insurance and Benefits Fund – Internal Service Fund for GASB reporting
- State Retiree Health Account – Fiduciary Fund for GASB reporting
- Due to/due from accounting entries to reflect entire balance in Internal Service Fund



Post-GASB 74 Accounting and CAFR Reporting



- One plan
- One appropriated fund
- Employees Life, Accident and Health Insurance and Benefits Fund – Internal Service Fund for GASB reporting
- State Retiree Health Account – Fiduciary Fund for GASB reporting
- Funds moved to State Retiree Health Account as needed



Pharmaceutical Rebates



- Allocation of pharmaceutical rebates was treated as an error correction
- GASB guidelines for error correction versus a change in account estimate
 - Error correction
 - Correct current year plus prior years in which the error occurred
 - Change in account estimate
 - Correct current year

Things to Come



- OPEB allocation schedules
- Employers will report proportionate share
 - Proportionate share of community colleges reduced by non-employer contributions
 - State covers 50% of premium

Questions?
Action Item



Public Agenda Item #3.2

Review of Internal Audit Reports



March 7, 2018

Tony Chavez, Director of Internal Audit

Vendor Information Technology Oversight



Tony Chavez, Director of Internal Audit

Karen Norman, Internal Auditor

Vendor IT Oversight Audit



To determine if oversight of vendors ensures protection of ERS information



Office of Procurement & Oversight

Provides oversight of contract management process and establishes policy

Information Systems Division

Subject matter experts

Business Divisions

Contract owners responsible for execution of policy

Vendor IT Oversight Audit

Sub-objectives



Scope Areas

Sub-objectives

Planning and Development

- Have IT requirements been established to ensure the protection and availability of ERS data?
- Have established IT requirements been incorporated into vendor agreements?
- Is an appropriate level of due diligence performed, ensuring vendors meet IT requirements?

Oversight

- Is vendor monitoring appropriately determined and based on identified IT risks?
- Is sufficient information obtained and disseminated to monitor vendor IT requirements?
- Are controls present to identify changes to vendor IT processes and is oversight adjusted accordingly?

Vendor IT Oversight Audit

Summary Results



Overall Assessment	Needs Improvement	
Scope Areas	Results	Rating
Planning and Development	Due diligence activities may not always provide verification of key requirements	Satisfactory
Oversight	Control activities have not been established to guide vendor IT oversight	Needs Improvement

Vendor IT Oversight Audit

Highlights



Key Controls Identified

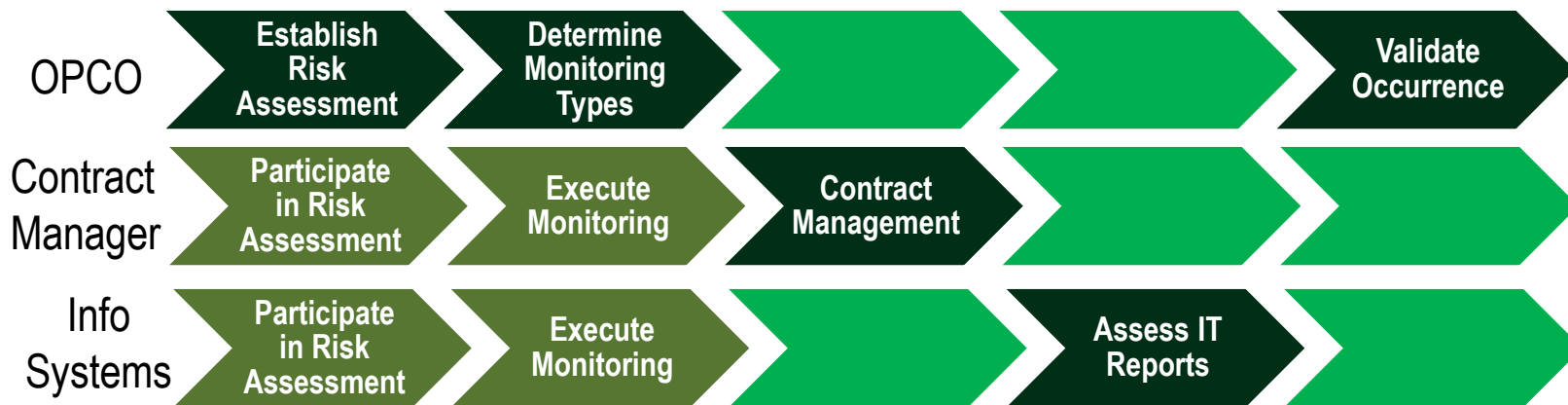
- SMEs involvement in creating requirements (*Planning & Development*)
- Requirements include Confidentiality, Integrity and Availability (*Planning & Development*)
- Onsite visit to Data Center, Service Organization Control (SOC) report review (*Planning & Development*)
- Contracts contain additional exhibits and requirements to align with type of data (*Planning & Development*)

Vendor IT Oversight Audit

Observation #1

Control activities have not been established to guide Vendor IT Oversight

- Oversight roles have not been fully refined



Vendor IT Oversight Audit

Observation #1



As the risk associated with a particular vendor increases, the level and degree of oversight should be increased by a corresponding level – Texas Contract Management Guide

- Vendor risk must be measured and assessed
- No agency-wide vendor IT risk framework has been established
- No assessment performed to measure vendor IT risk

Vendor IT Oversight Audit

Observation #1



*As the risk associated with a particular vendor increases, **the level and degree of oversight should be increased by a corresponding level** – Texas Contract Management Guide*

Monitoring types have not been differentiated:

- Onsite Inspections
- Report Reviews
- Annual Questionnaires

Reports Reviewed:

- Data Recovery Plan tests
- SOC reports
- DSBNA attestation

Vendor IT Oversight Audit

Observation #1



Reviewing vendor reports is not established

- Identifying elements that require further review
- Determine criteria

Vendor IT Oversight Audit

Observation #2



Due Diligence activities may not always provide verification of key vendor IT requirements

- Key Controls are present
- Identify IT requirements needing verification
- Have mitigating controls when verification cannot occur
 - Additional procedures are performed, but not required

Vendor IT Oversight Audit

Recommendations



Observation #1

Vendor Oversight helps assess and mitigate IT risks and should include

- Agreement on processes
- Set timeframes and measurement

Observation #2

Due Diligence should be evaluated

- Prioritize requirements needing verification
- Identify how verification can occur, including alternate procedures

Questions?



HealthSelect Denial Process



Tony Chavez, Director of Internal Audit

Jonathan Puckett, Internal Auditor

HealthSelect Denial Process Audit



Background

- **Audit Objective:** To determine if medical and drug denials were handled in accordance with master benefit plans
- **Audit Sub-Objectives:**
 - Third Party Administrator (TPA) Appeals
 - ERS Appeals
 - Stakeholder Engagement
- **Scope:** The audited period covered appeals received by ERS between September 1, 2015 through May 31, 2017

HealthSelect Denial Process Audit



Background

- HealthSelect members have a right to appeal a denied benefits claim
- Appeals process is a tiered approach as follows:



- ERS appeals are reviewed by the Director of Benefit Contracts
- Grievance Review Committee (GRC) reviews certain appeals
- Mediation may be available after claim denied, if member is eligible

HealthSelect Denial Process Audit

Background



Claims and Denial Statistics*

Total Claims	Claims Denied	TPA Appeals	ERS Appeals
11.4 Million	1.1 Million	4,860	803
\$3.8 Billion	\$205 Million	\$34 Million	\$11 Million

*Includes post-service claims September 1, 2015 - May 31, 2017

HealthSelect Denial Process Audit

Highlights



- Decision letters for denied appeals are thorough and contain key information.
- Appeal determinations are timely and sufficiently communicated by ERS.
- The appeals process is adequately communicated to members.
- Information provided to management and the Board is accurate.

Vendor IT Oversight Audit

Summary Results

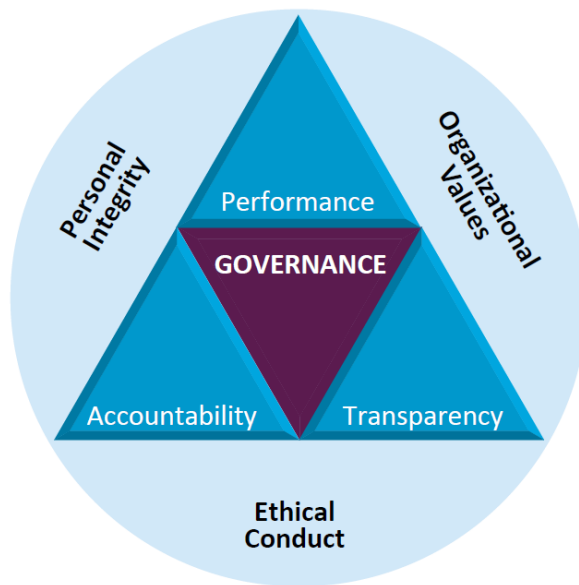


Overall Assessment	Satisfactory	
Scope Areas	Results	Rating
TPA Appeals	No reportable observations noted.	Satisfactory
ERS Appeals	<ol style="list-style-type: none">1. Intended governance over ERS appeals is unclear.2. Key information that supports appeals decisions is not consistently documented.	Needs Improvement
Stakeholder Engagement	No reportable observations noted.	Satisfactory

Governance

Governance is the exercise of authority, direction, and control over an organization.

– Institute of Internal Auditors



HealthSelect Denial Process Audit

Observations



1. Intended governance over ERS appeals is unclear.
 - GRC appeal approval authority is unclear
 - Appeals reviewed by GRC are not defined
 - GRC members intended role and responsibilities are not defined
 - GRC meeting attendance requirements are not clear

HealthSelect Denial Process Audit

Observations



2. Key facts that support appeals decisions are not consistently documented
 - Details of what was presented to the GRC are not documented
 - Basis for overturned (approved) appeals decisions is not consistently or thoroughly documented

Questions?



Investment Compliance Agreed-Upon-Procedures



Tony Chavez, Director of Internal Audit

Beth Gilbert, Internal Auditor

Jonathan Puckett, Internal Auditor

Investment Compliance Procedures



- Portfolio Compliance – No issues
- Personal Trading – No issues
- Proxy Voting – No issues
- Securities Lending – 1 issue
 - Counterparty below the 100% collateralization limit – 1 instance:
 - Instance was resolved after 4 business days

Questions?



Status of Audit Recommendations



Tony Chavez, Director of Internal Audit

Beth Gilbert, Internal Auditor

Status of Audit Plan Recommendations



Biannual

- January 1 to June 30
- July 1 to December 31

Implementation Status Ratings

- Implemented
- Partially Implemented
- No Action Taken
- Executive Management Acceptance of Risk

Methodology

- Management self-assessment
- Internal Audit review and analysis of supporting documentation
- Audit work not performed to verify the effectiveness of management actions implemented

Status of Audit Recommendations



Audit Engagement	Management Action Plan Owner(s)	Implemented	Partially Implemented
Hedge Funds Audit	Hedge Fund Director	1	1
Ethics Audit	Deputy Executive Director & General Counsel Director, Human Resources	1	

Questions?

